

FINANCE ADVISORY COMMITTEE

September 22, 1999

Highlights

- Arizona's leading economists expect the economy to continue growing through the year 2000.
- Consumer spending and construction have been extremely strong, but may start to slow as interest rates rise and job growth weakens.
- Several panel members recommended retaining the current budget revenue forecast growth rates for FY 2000 and FY 2001.

Do the economists on the Finance Advisory Committee (FAC) foresee yet another year of heady economic growth? The FAC is a 16-member panel that meets several times a year to advise the JLBC Staff on its economic and revenue forecast. Record-breaking economic conditions seem to be almost routine as of late, and the general opinion of the panelists is that the good times will continue for at least another year. The U.S. and Arizona economies will grow for the ninth consecutive year in 2000, but it seems that the expansion has finally passed its peak.

The opening presentation was made by Richard Stavneak and Kent Ennis of the JLBC Staff. Using a slide show, they outlined the key issue facing the Staff as it puts together its new revenue forecast. The final FY 1999 revenue total was \$99 million above the forecast, and Stavneak asked the committee if the FY 2000 and FY 2001 forecasts should be adjusted upward to reflect the higher FY 1999 base. He laid out three options: 1) to retain the current forecast dollar level which would reduce the growth rates, given the higher FY 1999 base, 2) to retain the April budget growth rates, or 3) to increase the April budget growth rates. Of the three panelists who commented, two chose the second option, and one chose the first. The general feeling of the three committee members was that the factors which caused the unexpected surge in FY 1999 revenues cannot be expected to repeat themselves in FY 2000 and FY 2001.

The next speaker on the agenda was Elliott Pollack, who presented the forecast for the national and state economies. Asserting that the underlying dynamics of the economy look good and pointing out that the large Baby Boomer age cohort has only recently entered its peak earning phase, Pollack opined that we need not fear a recession lurking on the horizon. However, he cautioned that growth periods usually die not of old age but from shocks, and shocks are not easy to predict. Pollack went on to say that over the past decade individuals have invested an increasing portion of their wealth in the stock market. As the stock market has soared to new heights, consumer spending has boomed. Consumer spending is the engine that is powering this expansion. Pollack thought that rising labor costs could result in an uptick in inflation and that retail sales and commercial and residential

building are at unsustainable levels. Finally, he recommended retaining the April budget revenue growth rates.

The next presentation was made by Tracy Clark, of Arizona State University, on the Arizona economy. Clark discussed employment levels in Arizona relative to other states. While our job growth rate has been slowing, we have still managed to maintain our position as a national leader in generating new jobs. The construction sector has been especially strong, Clark noted, but there appears to be a general slowing in some other sectors, particularly services. Employment statistics are considered to be a leading indicator of future trends in the economy, and a softening in employment could have repercussions throughout the economy. Clark explained that motor vehicle sales, especially purchases of sport utility vehicles, are a large component of Arizona's robust retail sales. He concluded by recommending the retention of the April budget revenue growth rates.

Next up was Marshall Vest, of the University of Arizona, who spoke about the outlook for the state economy. Echoing Pollack's comment, Vest asserted that consumers have been the driving force behind our economy's growth, as reflected by impressive levels of retail sales. Consumers have been closely watching the stock market, and, as the market posts gains, consumers feel more confident about their financial health and ability to purchase big-ticket items. However, Vest went on to sound a note of caution, warning that in the next year construction and retail sales could decline markedly. Precursors to a slowdown include rising interest rates, already declining levels of construction contracts, and a recently sluggish stock market. He recommended no revision to the dollar levels in the April forecast.

Senator Gnant then asked if the FAC was being too conservative in its projections for 2000, since economists have been saying for years that the economy is too good to be true and yet it still has continued to grow. Pollack answered by saying there is hard evidence that suggests a slowdown could occur. Pollack further stated that waning employment growth and declining commercial building contracts will impact the economy. He added that the age of business cycles and recessions is not over, even though economic growth has been so consistent this decade.

Wally Duncan, of Northern Arizona University, was the final speaker. After briefly delving into a mathematical explanation for inflation, he then opined that the Federal Reserve Bank would raise interest rates again this year to counteract rising inflation. He also suggested that the Fed fears the stock market is overvalued and is worried about speculative investing in the market.

Attendance at this meeting of the FAC numbered 39 people, including seven state legislators.